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No. 76-430

In the Supreme Court of the United States

OCTOBER TERM, 1976

ESTATE OF HERMAN KLEIN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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Solicitor General,
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Petitioners challenge the correctness of the decision in this federal income tax case that Bebe Klein was not an "innocent spouse" under Section 6013(e) of the Internal Revenue Code of 1954 (26 U.S.C.) so as to be entitled to relief from joint and several tax liability for taxes owing for a taxable year in which she filed a joint return with her husband.

1. The pertinent facts may be summarized as follows: During 1955, decedent Herman Klein was engaged in the manufacture of dresses as a 30-percent partner in the partnerships of Miss Smart Frocks and C & S Dress Company. These two partnerships filed partnership informational returns (Form 1065) for the taxable year ended April 29, 1955, which showed Herman Klein's 30-percent distributive share of ordinary net income to be

$90,845.89. His 30-percent share of the partnerships' gross income was $1,106,210.81 (Pet. App. 18a-19a).

Herman and Bebe Klein filed a joint income tax return for 1955, reporting interest income of $191.21, royalty income of $494.05, and net partnership income of $90,845.89 from Miss Smart Frocks and C & S Dress Co. On audit, the Commissioner of Internal Revenue determined that there was a $45,733.28 omission from gross income on the joint return (Pet. App. 35a). The Commissioner further determined that decedent's wife was not relieved of personal liability for the deficiency as an "innocent spouse" under Section 6013(e), on the ground that the amount omitted from gross income did not exceed 25 percent of the $1,106,896.07 of gross income stated in the return, as required by Section 6013(e)(1)(A) (Pet. App. 18a-19a). The Tax Court upheld the Commissioner's determination (Pet. App. 29a), and the court of appeals affirmed (Pet. App. 1a-12a).

2. The decision below correctly held that petitioner Bebe Klein did not qualify for relief as an "innocent spouse" from personal liability for the deficiency determined upon audit of the joint return she filed with her husband. Section 6013(e) relieves a spouse from joint and several tax liability only if three statutory requirements are met. The only pertinent requirement here[1] is that there must be an omission from gross income "which is in excess of 25 percent of the amount of gross income stated in the return." See Section 6013(e)(1)(A) (Pet. App. 30a). Section 6013(e)(2)(B) further provides that

[1]The parties stipulated that Bebe Klein did not know of the omission of income from the joint return which she signed, and did not significantly benefit from the items omitted. She therefore met the other two requirements set forth in Section 6013(e)(1)(B) and (C) (Pet. App. 35a).

"the amount omitted from gross income shall be determined in the manner provided by section 6501(e)(1)(A)." Finally, Section 6501(e)(1)(A) establishes a six-year period of limitations for the assessment or collection of certain taxes when "the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return * * *."

Petitioners contend (Pet. 10) that Section 6013(e)(2)(B) only requires that Section 6501(e)(2)(B) be consulted to determine the "amount of gross income omitted from the return" but not to determine "the amount of gross income stated in the return." They argue that in construing these statutory provisions, the net amount of partnership income actually put down on their individual return is the amount "stated" in the return.

The partnership income set forth on Herman and Bebe Klein's joint income tax return was properly reported on the basis of net income rather than gross income. But as petitioners concede (Pet. 10), in computing a partner's gross income under Section 6501(e)(1)(A) to ascertain whether the six-year statute of limitations applies, Herman's share of the gross income of the partnerships must be included in the computation.[2] *Davenport* v. *Commissioner*, 48 T.C. 921, 928. See also Rev. Rul. 55-415, 1955-1 Cum. Bull. 412. Since the computation of the amount omitted by petitioners from their gross income is required by Section 6013(e)(2)(B) to be determined in the manner provided by Section 6501(e)(1)(A), a

[2]The definition of gross income of a partner in Section 702(c) states that a partner's gross income shall include his distributive share of gross income of the partnership. See also Treasury Regulations on Income Tax (1954 Code), Section 1.702-1(c)(2) (26 C.F.R.).

member of a partnership, such as Herman Klein, must refer to his share of the *gross* income of the partnerships in making the statutory computation.

Once it is recognized that the partnerships' gross income, and not their net income, is the amount to be used in the foregoing computation, it follows that the determination of the amount of such gross income omitted is derived simply by subtracting from the correct amount of partnership gross income the amount of such partnership gross income stated in the partnership return.[3] As the Tax Court (Pet. App. 24a) and the court of appeals (Pet. App. 10a-12a) correctly held, for the purpose of these computations the partnership return must be considered an adjunct of the individual return,[4] and the gross income stated in the partnership return is necessarily an "amount of gross income stated in the return" within the meaning of Section 6013(e)(1)(A).[5]

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[3]As the Tax Court noted (Pet. App. 22a), a computation of gross income omitted from a return necessarily results in the simultaneous determination of the amount of gross income stated in the return.

[4]A partnership is not a taxable entity and the partnership return required to be filed by a partnership is not an income tax return but an information return. See Sections 701 and 6031.

[5]The pertinent legislative history also supports the decision below. In describing the manner in which these interrelated provisions were to operate, the Senate Finance Committee stated (S. Rep. No. 91-1537, 91st Cong., 2d Sess. 3 (1970)):

> The first requirement, that the amount omitted from gross income must equal more than 25 percent of the gross income shown on the return, is intended to limit the relief provided in the bill to those cases where the income omitted represents a significant amount relative to the reported income. Whether or not an omission meets this test is to be determined in a manner similar to the test applied under existing law in determining, for purposes of the 6-year statute of limitations [Section 6501(e)(1)(A)], when an omission in excess of 25 percent of gross income exists.

See *Rodman* v. *Commissioner*, P-H Memo T.C., par. 73,277, decided December 19, 1973, affirmed without discussion of this point, C.A. 2, No. 75-4211, September 17, 1976.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1976.